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SUBJECT: The Japan Economic Scope - Economic News At-A-Glance.

Sensitive but unclassified. Please protect accordingly.

¶1. (SBU) Table of Contents

¶2. (U) The Japan Economic Scope (JES) is a weekly e-newsletter produced by Embassy Tokyo's ECON section in collaboration with other sections and constituent Posts and published every Friday. It provides a brief overview of recent economic developments, insights gleaned from contacts, summaries of the latest cables and a list of upcoming visitors. This cable contains the December 22, 2006, JES, minus the attachments that accompany many of the individual stories in the e-mail version. To be added to the e-mail list, please email

ProgarJ@state.gov.

¶3. (U) LDP Member Tatsuya Ito Reviews Regional Architecture Policy
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Liberal Democratic Party diet member Tatsuya Ito shared his views on a future economic regional framework for East Asia during EMIN's December 21 courtesy call.

Ito demonstrated detailed knowledge of the FTAAP proposal in APEC, U.S. proposals to strengthen the institution, as well as the GOJ ASEAN plus 6 initiative.
He followed the line typically offered by METI that Japan's ASEAN plus 6 free trade area proposal should be seen as complementary to and supportive of U.S. efforts to strengthen APEC, and could provide a basis for FTAAP.
Ito suggested that the United States, China and Japan should form a joint framework in which they could discuss economic and national security interests in the future.

Ito currently is the chairman for an LDP special committee on Japan's official development assistance programs.

A representative of a Tokyo district in the lower house in the Diet and very close to former Economic and Financial Policy Minster Takenaka, Ito has spent considerable time in the United States. He prefers to speak in Japanese, however.

4.(SBU) Japan - Australia FTA: GOJ Will Drive Hard Bargain

PM Abe and his Australian counterpart, John Howard, announced the launch of free talks last week, but interest in carrying the talks

to a successful conclusion at the working level may not be so keen if Australia does not agree to major concessions on agricultural trade. For more on what we heard from two key Foreign Ministry officials this week, please see Tokyo 7081.

¶5. (SBU) Kagoshima Farmers: EPA with Australia, No Worries Mate?

A senior researcher at the Kagoshima Regional Economic Research Institute noted that Kagoshima farmers are relatively calm about the latest discussions of an economic partnership agreement (EPA) between Japan and Australia.

Although Kagoshima Governor Yuichiro Itoh recently stressed the need for sensitive agricultural items to be excluded from the EPA to minimize "catastrophic damage" to Japanese farmers, the researcher views the statement as a typical one to placate voters.

Kagoshima ranks second in Japan in agricultural output and its livestock industry is one of the largest in Japan.

The researcher believes that the EPA could help strengthen the local livestock industry the same way that the 1988 U.S.-Japan trade liberalization agreement on U.S. beef and oranges triggered an impetus for local farmers to upgrade their products into popular specialty brands.

While an EPA may be a big threat for farm organizations (e.g. agricultural cooperatives) which have already been pressed to streamline their operations, it may not be as big of a concern for local livestock farmers who are already successfully producing value-added products.

¶6. (SBU) Beijing Energy Ministerial Outcome: METI, MOFA Pleased
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Ministry of Foreign Affairs (MOFA) and Ministry of Economy, Trade and Industry (METI) officials who attended the December 16 Beijing Energy Ministerial agreed that the one-day meeting to discuss regional energy issues had been very useful.

Proposed by China in March 2006, the gathering included energy ministers from Japan, China, India, South Korea and the United States, countries that collectively consume almost 50 percent of the world's energy and contribute more than 50 percent of global carbon dioxide emissions.

The ministers' joint statement included calls for greater energy diversification, improved energy conservation and efficiency, strengthened cooperation over strategic oil stocks, and better data transparency.

¶7. (SBU) Transparency: GOJ Translations of Laws and Regulations
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The government decided at a Cabinet meeting on December 19 to establish a section at the Justice Ministry in fiscal year 2009 to handle the English translations of Japanese laws and regulations concerning businesses as part of measures to promote more foreign investment, according to press reports.

The new section will take over this work from a task force on judicial reform at the Cabinet Secretariat which had been doing the translations, but will be disbanded at the end of fiscal 2008.
In fiscal 2009, the Justice Ministry will also set up a new Web site that allows users to search for legal terms and clauses.

Translating more Japanese laws has been a long-term objective of the Bilateral Investment Initiative.
In the Initiative's June 2006 report, the USG welcomed the GOJ decision to begin translating some 200 laws and regulations into English. For existing English translations on the GOJ's Cabinet Secretariat's website click here.

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¶8. (U) GOJ e-Gov Web-portal for Public Comment on Proposed Laws and Regulations
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The U.S. Commercial Service Japan provides a weekly summary in English of the titles of documents posted on Japan's online equivalent to the Federal Register.
The English weekly summary of these translations can be found on the Buy USA website, while the GOJ's list of laws and regulations open for public comment is accessible via the GOJ's e-Gov web-portal.
¶9. (SBU) Postal Privatization Committee Releases New Product Guidelines
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The Postal Services Privatization Committee (PSPC) released a viewpoint on December 20 concerning the conditions under which the privatized postal insurance and banking entities will be allowed to introduce new products. Most newspaper reporting has focused on the decision that the entities will be allowed to introduce products before their IPOs.

Industry contacts have expressed concern about the document, particularly its lack of a clear pledge to ensure a level playing field, but observers are mulling over the document's meaning, as its language is quite vague and open to interpretation.

¶10. (U) FY07 Tax Reform Details Revealed

Japan's ruling coalition announced a package of tax reform proposals on December 14, featuring the first net tax cut in four years by lowering the corporate tax burden, particularly on depreciable assets.

Proposals made by the coalition parties included a call for full amortization of corporate facilities and equipment; despite the existence of the Government Tax Committee, the coalition's holds virtually all the power to decide tax changes.

The coalition parties also proposed extending the present temporary measures of a cut in the tax rate on both capital gains from share sales and dividend income by one year after their scheduled repeal in FY07.
Despite calls from business circles, the coalition made no reference to reducing the effective income tax rate for companies from the present 40 percent.

These FY07 tax change proposals are limited to minor changes in Japan's tax system, reflecting a consensus among policymakers that deliberations on major tax reforms, including a consumption tax hike, should be shelved until next fall, after Upper House elections to be held in July 2007.

Refer to attached document for more analysis.

¶11. (SBU) CEFP Member Advocates "Labor Big Bang" for Growth

Council for Economic and Fiscal Policy (CEFP) private sector member Naohiro Yashiro is promoting a "labor big bang" as a pillar of the Abe administration's new growth strategy.

Yashiro sees many of Japan's labor market structures as out-of-step with the world economy and he has been publicly advocating deregulation as a way of increasing labor market mobility, productivity, and the national growth rate.

See Tokyo 7064 for details.

¶12. (U) Regional Governors Approve Haneda Airport Expansion

Tokyo Governor Shintaro Ishihara and Chiba Governor Akiko Domoto visited Transportation (MLIT) Minister Tetsuzoo Fuyushiba on December 18 and acquiesced in the ministry's request to cooperate in building the fourth runway at Haneda airport.

Construction will require that landfill be used to displace part of the bay area in Tokyo where the runway will be built.

Fuyushiba pledged to continue to negotiate with some 22 fishermen's associations from Chiba prefecture to secure their cooperation.

These talks are expected to delay the start of the project, although MLIT announced that a drilling survey would begin on December 20.

The Ministry's target completion date for the project is the end of
¶2009.

¶13. (SBU) UA to Drop Osaka-Chicago Route in January
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A senior United Airlines official in the region told us on December 19 that United will suspend its Kansai International Chicago flight as of January 20. High fuel costs and low demand have made the route unsustainable.

He said that United remains committed to the Kansai market and the decision was not a criticism of Kansai International Airport or the region. The airline will continue to offer two daily flights to the United States, to San Francisco and Honolulu.

For more on the discussion with the United representatives about aviation in Japan and the region see the attached.

¶14. (U) Air Talks: Japan-India Tripling Capacity
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Japan and India agreed in bilateral aviation talks to increase air service between the two countries by three-fold. PM Singh and PM Abe welcomed the measures in their December 15 Joint Statement, during PM Singh's visit to Tokyo.

The agreement allows 21 flights per week from each country,

codeshare with carriers of each country as well as third country's carriers, and wet lease with the same country's carriers. Up to seven cargo flights per week are permitted within the agreed capacity.

Since Indian flights to Narita will remain at four a week, primarily dictated by space constraints at Tokyo's main airport, the additional capacity would have to be added at some of Japan's regional hubs.

¶15. (U) Fujio Mitarai: New Chairman of MLIT's Transportation Policy Committee
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On December 12, the Transportation Policy Committee (TPC) selected Fujio Mitarai, currently Chairman of Cannon and also of the Japan Business Federation (Keidanren), to become its chairman.

The TPC provides research and advice to the Minister of Land, Infrastructure and Transport (MLIT). The TPC has 30 members drawn from business leaders and academia. The previous chairman, Hiroshi Okuda, resigned on November 25.

TPC subcommittees cover issues such as roads, rivers, city planning, historical landscape, aviation, ports and harbors. For more information in Japanese, click here.

¶16. (U) Association of Asia Pacific Airlines (AAPA) Concerned Over EU's Aviation Emissions Trading Proposal
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The AAPA on December 21 issued a press release that criticized the European Commission proposals to include aviation in the European Union emissions trading scheme, particularly the EC's unilateral approach to impose charges on international airlines operating in international airspace outside the EU.

The AAPA is the trade association of 17 scheduled international airlines based in the Asia-Pacific region, with a permanent secretariat in Kuala Lumpur, Malaysia and international

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representation in Brussels and Washington, D.C.

AAPA member airlines carry 270 million passengers and 10 million tons of cargo; approximately one-fifth of global passenger traffic and one-third of global air cargo traffic.

¶17. (SBU) Japanese Customs and Express Mail Service

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To gain a better understanding of customs clearance processes and how they may differ between Japan Post's express mail services versus private industry's, Econoffs visited the recently opened Tokyo International Post Office.

Officers viewed state-of-the-art equipment including voice activated mail sorting and advanced barcode tracking systems.

Customs officers are co-located in the facility free-of-charge to Japan Post to speed clearance, a fact much lamented by private industry.

When asked, Japanese officials parried that the clearance system used by industry (NACCS) is much more efficient by comparison and is in fact a competitive advantage.

Tokyo International Post Office EMS volume has increased steadily over the past three years reaching 9.3 million packages in 2005, an increase of 3 percent, while regular mail volume has steadily declined, reaching 39.4 million, or minus 6 percent.

China accounts for the largest inbound (34 percent) and outbound (23 percent) volume of mail compared to the U.S., which accounts for 21

percent of inbound volume and 15 percent of outbound volume.

¶18. (U) Japan Automobile Manufacturers Association, Inc. (JAMA) Criticizes Proposals to Revise Road Taxes
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On December 14, JAMA issued a statement on the GOJ proposal for revisions of the national tax system for fiscal year 2007.

JAMA welcomed reform of the depreciation system and the provisions for reduced tax rates on vehicles with a strong environmental performance.

JAMA disparaged suggestions to modify the road tax system, which earmarks road tax revenues for road construction, and was disappointed that there were no provisions for reducing the corporate effective tax rate.

¶19. (U) Maritime Policy Law Being Drafted

The ruling parties have prepared a draft basic marine law for submission to the ordinary Diet session in 2007, according to press accounts.

The draft law would establish a marine policy panel within the Cabinet Office chaired by the Prime Minister, and create a new Minister of State in charge of ocean policy, integrating control of ocean and maritime policies that are now spread among several ministries and agencies, including management of the exclusive economic zone, protection and preservation of the marine environment, development of underwater resources and marine transport and safety.

If the Diet passes the bill, it will be the first law to incorporate all marine policies.

The press reports that the GOJ has been criticized for not having comprehensive marine policies, noting Japan's response to marine-problems, such as China's gas field development in the East China Sea, has been slow.

A Defense Agency contact told us that a private study group called "The Basic Ocean Law Study Group," headed by former Defense Agency Director General Shigeru Ishiba and consisting of volunteer Diet members and scholars, has been studying ocean issues and regulations for the past year and came up with a draft of the bill.
This group also has been working with LDP's "Extraordinary Meeting of Ocean Policy" group and held discussions with MAFF, the Defense Agency, MLIT (Japan Coast Guard), MOFA, MOE, METI, MEXT, National Public Safety Commission (upper structure of the National Police Agency) and MOF.

¶20. (U) MAFF Stocks Release Hurts U.S. Rice Flour Mix Exports
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U.S. exports to Japan of rice flour mixes dropped by 12 percent during the January-October 2006 period despite reassurances from the Agriculture Ministry (MAFF) that this long-standing trade would not be displaced when MAFF introduced a new program to reduce imported rice stocks in July 2005.

U.S. rice flour mix exporters ship roughly 30,000 mt (approx. $20 million) of rice flour mixes to Japan a year.

New information indicates that at least one Japanese bakery that exclusively used U.S. rice flour mix imports for their product is now planning to build facilities to produce the mixes themselves using imported rice stocks purchased from MAFF. MAFF will reveal neither the selling price of the rice nor the quantity sold.
The USG has raised this potential "import substitution" issue on a number of occasions both in Tokyo and in Washington.

In the most recent meeting in Tokyo on December 20, MAFF stood

firmly behind the program.

¶21. (U) Beef "Pipeline" Released

On December 18, Japan released 700 of the 706 tons of frozen U.S. beef that had been held since January (the last time U.S. beef imports were stopped).

This decision came after several months of hard negotiations involving USDA, the Embassy, MHLW, and MAFF.

The release of this beef was timely because supplies are tight and prices are high.

Yoshinoya, the largest user of U.S. beef in the world, has been counting on these stocks to continue its current U.S.-beef promotion.

This action ends several commercial disputes over losses related to beef that were, until now, quarantined by the Japanese government for unstated reasons.

For the remaining six tons of beef, Japan is requesting an investigation into a single box of beef that possibly came from an animal slaughtered on day prior to the plant being approved for export to Japan.

¶22. (U) MAFF Sets Beef Safeguard Level

This week MAFF set the level of beef imports in 2007 that would trigger additional duties under Japan's "beef safeguard" at the same level as 2006. This recommendation will be rubber-stamped by the Diet early next year.

This means that additional duties will not be levied unless beef imports in 2007 exceed the average for 2002-2003 levels, or 117 percent of the most recent year's trade data, whichever is higher.

This is a good outcome but much depends on when -- and to what extent -- Japan lifts the current age restrictions on U.S. beef, which will lead to a surge in imports.

In previous years the Embassy's discussions with MAFF have been contentious but this year things went smoothly, likely due to high prices for beef and declining overall consumption.

Japan's beef safeguard was negotiated during the Uruguay Round to afford protection to domestic producers in the event of an import surge.

Normally, the safeguard is triggered when imports increase by more than 17 percent from the previous Japanese fiscal year on a cumulative quarterly basis.
Once triggered, the safeguard remains in place for the rest of the fiscal year. If triggered, beef tariffs will rise to 50 percent

from 38.5.

¶23. (U) Status of U.S. Beef Sales

Revised Embassy estimates, based on trade-reported figures, show that Japan will import about 10,000 MT of beef in CY 2006 worth nearly $50 million. This is a fraction of the $2.4 billion level in previous years.
Only U.S. beef from cattle 20 months and younger is allowed into Japan and only a small percentage of the cattle slaughtered in the Untied States meet this requirement.

A recent survey by the Japanese Food Service Industry shows that 40 percent of restaurants were not serving U.S. beef because of its high price.

Of those that do carry U.S. beef, 70 percent said that they could only source 30 percent of needed supplies due to high prices and low supply.

¶24. (U) Japan Set to Ban Wagyuu Beef?

Japan looks set to clamp down on imports of "Wagyuu" beef, developing onerous labeling requirements that would ban use of the term "Wagyuu" on beef from cows not born and raised in Japan.

About a third of cattle produced in Japan is Wagyuu, producing a high value added, heavily marbled meat.
The United States does not currently export Wagyuu to Japan, owing to other trade restrictions already in place -- primarily the ban on U.S. beef from cattle over 20 months old.

There is a U.S. Wagyuu industry which will feel the effects of the new labeling requirements once -- if -- the age restrictions are lifted, and the Embassy has been working with our Australian counterparts in making our concerns known to GOJ authorities.

The labeling issue also may have implications for Japan's approach to the broader geographical indicators dispute that the United States has had with the European Union.

For more on the trade problem, please see attached report.

¶25. (SBU) Trade Distortions: Pork Gate Price

Japan's "gate price" system of calculating duties for pork imports distorts trade and is plagued with illegal schemes.

Japan has to date said that it will only reform the system as part of the Doha negotiations.

Recent criminal indictments, however, and credible rumors that an icon of Japanese industry -- Mitsubishi -- is being investigated, are creating domestic pressure for reform.

There may be an opportunity soon for the United States to push for a simplified tariff system outside of Doha.
Japan is the world's largest importer of pork and U.S. exports to Japan topped a record $1 billion in 2005.

Under the current system, pork meat imports, priced at entry into Japan, are valued at or above the gate price (524 yen/kilo), then they pay a simple tariff of 4.3 percent.

If their value is lower than the gate price, the importer must pay the difference between the import value and the gate price as a duty.

A 4.3 percent specific duty is also applied. This system creates a strong incentive for fraud by over-invoicing.

¶26. (U) GOJ Projects 2.0% GDP Growth in JFY '07

On December 19, the Abe Cabinet approved the GOJ's official economic forecast for JFY07 (April 2007 to March 2008).

The forecast, prepared by the Cabinet Office and used in MOF's revenue projections for the regular budget, is in line with market consensus in terms of nominal growth outlook, but slightly optimistic about the real growth outlook.

The official forecast projects a 2.0 percent increase in real GDP for next fiscal year, a 2.2 percent increase in nominal GDP, and a 0.2 percent increase in the GDP deflator.
By contrast, private analysts on average project FY07 real GDP growth at 1.9 percent and project a 0.3 percent increase in the GDP deflator, for 2.2 percent nominal growth.

See attached for details.

¶27. (U) Japan's Cabinet Approves "Housekeeping" Supplemental Budget for FY06

The Cabinet approved MOF's fiscal 2006 supplemental budget proposal on December 20, clearing the way for Diet action.

Under Japanese Government accounting rules, the supplemental adds a net Q3.8 trillion ($33 billion or 0.7 percent of GDP) to general account expenditures.

However, Q0.8 trillion of the supplemental budget's additional "spending" consists of financing operations, representing an increase in government financial assets (and a decline in net debt) rather than spending on a national accounts basis.

Most of the remaining Q3 trillion ($26 billion or 0.6 percent of GDP) in net additional spending consists of inter-government transfers, disaster relief, and greater-than-projected mandatory spending.

The increase in actual spending was more than offset by 4.8 trillion ($40 billion or 0.9 percent of GDP) in higher-than-projected government revenues.

See attached for details.

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